Draft Language Fails to Adequately Divide Commercial Banking and Investment Activities

Washington, DC -- Congressman Maurice Hinchey (D-NY) and Congressman Peter Welch (D-VT) today wrote Federal Reserve Chairman Ben Bernanke, requesting that he reject the current draft of the Volcker Rule regulations and replace it with stronger language to prohibit commercial banks from engaging in investment activities. The Volcker Rule, as authorized by the Wall Street Reform and Consumer Protection Act, is intended to prohibit commercial banks and bank holding companies from engaging in proprietary trading and owning or investing in a hedge fund or private equity fund. The Hinchey-Welch letter, also signed by 15 other House members, argues that the Federal Reserve's draft regulations to implement the rule fall short.

"Unfortunately, the Federal Reserve's draft Volcker Rule is unnecessarily complex and includes several large loopholes that undermine Congress's intent to protect banking deposits from risky trading activities," wrote the members. "For example, under the draft rule, commercial banks would be allowed to engage in market making and hedging activities that can provide easy cover for risky proprietary trading. The draft rule also relies too heavily on banks to self regulate and self report."

Former Federal Reserve Chairman Paul Volcker, for whom the rule is named, recently criticized the draft rule. "I'd love to see a four-page bill that bans proprietary trading and makes the board and chief executive responsible for compliance," said Chairman Volcker. "And I'd have strong regulators. If the banks didn't comply with the spirit of the bill, they'd go after them."

Co-signers of the letter include: David Cicilline (D-RI), John Conyers, Jr. (D-MI), Peter Defazio (D-OR), Bob Filner (D-CA), Raul Grijalva (D-NM), Mazie K. Hirono (D-HI), Jesse Jackson Jr. (D-IL), Denis Kucinich (D-OH), Jim McDermott (D-WA), Grace Napolitano (D-CA), Eleanor Norton (D-DC), Jan Schakowsky (D-IL), Louise Slaughter (D-NY), Pete Visclosky (D-IN), Lynn Woolsey (D-CA).

The full text of the letter follows:

Dear Chairman Bernanke:

We write to express our serious reservations about the draft "Volcker Rule" recently proposed by the Federal Reserve. We believe the draft rule falls far short of the reform needed to protect our country from the kind of risk-filled financial activities that caused havoc on our economy. In order to ensure our country is never again faced with a repeat of the recent financial crisis, we urge you to reject the draft Volcker Rule and replace it with a strong and simple rule that prohibits commercial banks from engaging in investment activities.

The financial collapse of 2008 and current state of our economy are a direct result of the deregulation of the banking sector which brought about the creation of the too-big-to-fail mammoth financial institutions. In response, Congress passed The Wall Street Reform and Consumer Protection Act, which contained critically important reforms to protect our country from future financial meltdowns.

One of the most important elements of that legislation was the Volcker Rule, which was designed to restore some of the separations between investment and commercial banking operations that were put in place following the Great Depression but was unfortunately repealed in 1999. Known as the Glass Steagall Act, this important reform eliminated the material conflict of interest associated with the comingling of commercial and investment banking activities. This prevented commercial banks from gambling with their depositors' money and paved the way for decades of prosperity and stability in the banking sector.[1]

Unfortunately, the Federal Reserve's draft Volcker Rule is unnecessarily complex and includes several large loopholes that undermine Congress's intent to protect banking deposits from risky trading activities. For example, under the draft rule, commercial banks would be allowed to engage in market making and hedging activities that can provide easy cover for risky proprietary trading. The draft rule also relies too heavily on banks to self regulate and self report.

These large loopholes will not only allow banks to continue the risky activities the Volcker Rule was designed to prohibit, but they will make enforcing the Volcker Rule incredibly difficult. Under the draft rule, regulators will be challenged with determining whether banks are masking prohibited trading under the guise of one of the many exemptions allowed under the rule.

We agree with former Federal Reserve Chairman Paul Volcker's criticism of the draft rule that was named after him. "I'd love to see a four-page bill that bans proprietary trading and makes the board and chief executive responsible for compliance," said Chairman Volcker. "And I'd have strong regulators. If the banks didn't comply with the spirit of the bill, they'd go after them."[2]

We urge you to heed Chairman Volcker's advice. Wall Street should no longer be allowed to gamble with our economic well-being by engaging in high risk proprietary trading and if any bank violates the spirit of the rule, the banks, and the people who run them, should be held accountable.

Sincerely,

Maurice D. Hinchey
U.S. Representative

Peter Welch
U.S. Representative